FitchRatings

Fitch Rates Metro St. Louis Sewer District, MO's $150MM Wastewater Revs 'AA+'; Outlook Stable

Fitch Ratings-Austin-18 November 2016: Fitch Ratings has assigned a 'AA+' rating to the following Metropolitan St. Louis Sewer District, Missouri (the district) revenue bonds:

--Approximately $150 million wastewater system improvement and refunding revenue bonds series 2016C.

The bonds are scheduled to sell via negotiated sale the week of December 5. Bond proceeds will be used to finance a portion of the district's capital improvement plan (CIP) costs, advance refund outstanding bonds for savings, and pay costs of issuance.

In addition, Fitch has affirmed the 'AA+' rating on the following district bonds:

--$860.5 million in outstanding wastewater system revenue bonds.

The Rating Outlook is Stable.

SECURITY

The bonds are payable from net revenues of the district's sanitary sewer system (the system). No debt service reserve is being funded in connection with the series 2016C bonds.

KEY RATING DRIVERS

HEALTHY COVERAGE MARGINS PROJECTED: Total debt service coverage (DSC) was solid at 2.1x in both fiscals 2015 and 2016. DSC margins are expected to weaken slightly to around 1.8x over the fiscal 2017 through 2020 period but are still healthy for the 'AA+' rating level.

ESCALATING DEBT BURDEN: Leverage ratios currently are moderately-high with debt per customer at approximately $3,100. Debt is projected to nearly double over the next five years as a result of additional borrowing needs to address regulatory requirements. Furthermore, debt amortization is below average with principal payout at 33% and 73% in 10 to 20 years, respectively.

VOTER SUPPORT FOR DEBT: The district's charter requires voter approval of new debt issuance. Strong approval levels experienced to date should provide ongoing support for rate increases related to future debt. Moderate rates should provide rate flexibility.

STRONG LIQUIDITY: Liquidity margins are projected to remain strong. Current cash and investments at year end fiscal 2016 equaled 724 days cash on hand (DCOH) including noncurrent unrestricted investments.

STABLE AND DIVERSE ECONOMY: The system serves a sizeable, diverse and stable service area.

RATING SENSITIVITIES

REDUCED FINANCIAL MARGINS: Metropolitan St. Louis Sewer District, Missouri's maintenance of very strong financial metrics will be critical to maintenance of the rating given the rapid escalation in system debt. Coverage margins that fall below forecasted levels would be expected to result in negative rating action.

CREDIT PROFILE

REDUCED BUT STILL SOUND FINANCIAL METRICS

Total DSC (including senior and subordinate-lien debt) coverage levels have been on a somewhat downward trend since fiscal 2010 with senior lien ADS coverage dropping to 3.3x in fiscal 2016, from a high of 6.2x in fiscal 2009; total ADS coverage was 2.1x in fiscal 2016, down from 2.7x in fiscal 2009. The decline has been driven mostly by an increase in borrowing costs related to the district's capital improvement and replacement program (CIRP) that have resulted in a two-fold increase in total debt service costs from fiscal 2009 to fiscal 2016 and a decline in investment earnings.

Due to the planned borrowings associated with the CIRP and consent decree, total coverage on all outstanding and anticipated debt is projected to be slightly lower, somewhere in the 1.8x to 1.9x range and coverage on senior lien debt is projected to be in the 2.6x to 2.8x range in fiscals 2017 to 2020. Fitch's rating incorporates the slightly weaker DSC, although any deterioration in financial performance beyond projected levels would be expected to result in negative rating action.

Reserve balances remain very strong, with available current cash and investments at 2016 fiscal year-end equal to $183 million or 390 DCOH. This amount does not include an additional $157 million in unrestricted long-term (average duration of 1.4 years) investments, which nearly doubles system reserves. Based on issuer projected cash flows through fiscal 2020, cash balances are expected to remain within historical norms.

REGULATORY DRIVEN CAPITAL PLAN

The district executed a consent decree with the U.S. Environmental Protection Agency in July 2011 that substantially aligns with the district's CIRP. The consent decree provides for an estimated $4.7 billion (in 2010 dollars) in projects implemented over 23 years that include the elimination of sanitary sewer overflows (SSO), implementation of the combined sewer overflow (CSO) long-term control plan, and asset reinvestment. The consent decree was entered into on April 27, 2012 with no substantive changes after the public comment period. The district has appropriated approximately $900 million in consent decree related capital projects through fiscal 2016.

RISING DEBT AND CAPITAL NEEDS

The fiscal years 2017 - 2020 capital program totals a substantial $1.5 billion, with approximately 45% of the costs focused on SSO remediation, 20% for CSO control, and the remainder dedicated for other system projects and wastewater treatment.

Approximately 72% of the plan through fiscal 2020 is expected to be funded from existing and planned debt. Leverage ratios are expected to continue escalating through the CIP period, with outstanding debt per customer increasing from $3,113 at the end of fiscal 2016 to over $5,400 by fiscal 2020 (relative to Fitch's sector 'AA' median of $2,308 in five years). Furthermore, debt amortization is below average with principal payout at 33% and 73% in 10 to 20 years, respectively (the new money portion of the series 2016C bonds is being issued as 30-year fixed rate debt).

Bonding capacity requires voter approval and the board maintains strong voter confidence, as evidenced by the 85% approval rate of the recent $945 million authorization in June 2012. The series

2012A bonds issued in July 2012 represented the first installment of the 2012 authorization to fund a portion of the CIRP/consent decree requirements. The current offering represents the sixth installment of the 2012 authorization; new money bond proceeds will be used to provide funding for collection system improvements to reduce SSO's and CSO's, reduce building backups, initial design work on storage tunnels, tanks and relief sewers to improve system capacity, and begin construction of the Deer Creek Sanitary Tunnel ($150 million).

REDUCED AFFORDABILITY

To support the additional planned debt, the board approved annual rate increases averaging 9% in fiscals 2012 through 2016. The fiscal 2016 average monthly wastewater bill of $43.99 (assuming Fitch's standard usage of 8.02 hundred cubic feet, or 6,000 gallons of sewer flows per month) is considered affordable at 0.8% of MHI. The board accepted the rate commission's proposed 2017 to 2020 rates in October 2015 with few changes, and voters overwhelmingly approved $900 million in additional bonding capacity and thus, the multi-year annual rate increases needed to support the additional debt. Rates will increase by an annual average of 11% (assuming Fitch's standard usage of 8.02 hundred cubic feet, or 6,000 gallons of sewer flows per month) over the fiscal 2017 to 2020 period, and are projected to approach Fitch's affordability threshold of 1.0% of MHI by fiscal 2018.

SERVICE AREA

Serving a population of around 1.3 million and roughly 423,000 accounts, the district was established in 1954 to provide wastewater treatment and stormwater services to both the city of St. Louis and the vast majority of St. Louis County. The customer base is stable, with accounts experiencing flat growth over the past five fiscal years.

For September 2016, the county unemployment was 4.5%, compared to the state rate of 4.7% and national rate of 4.7%. The St. Louis metropolitan area is the primary economic engine for Missouri and home to a number of Fortune 1,000 companies. Given its access to major waterways, it is a hub for trade and distribution.

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Applicable Criteria
Revenue-Supported Rating Criteria (pub. 16 Jun 2014) (https://www.fitchratings.com/site/re/750012)
U.S. Water and Sewer Revenue Bond Rating Criteria (pub. 03 Sep 2015)
(https://www.fitchratings.com/site/re/869223)

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